

The Case for Military Pension Reform



Survivors attend commemoration of 70th anniversary of Japanese attack at Pearl Harbor

By JON P. SUNDERLAND

If the Department of Defense (DOD) fails to reform its military retirement system, it will find itself in the same place as General Motors (GM) during the last decade. With GM management focused on maintaining the status quo, staggering legacy costs provided health care and pensions to millions of retirees totaling nearly \$2,000 per vehicle.¹ A cumbersome and unresponsive bureaucracy suggests a management failure in organization that lasted over decades as market share consistently

declined. As a result, morale in the workforce declined and a sense of corporate responsibility was never asserted by leadership. In effect, GM was unable to keep up because it was unwilling to change. Rather than act on the financial inequities clearly present in early analysis, leadership chose to pass the buck to consumers, contributing to a declaration of bankruptcy in 2009 and one of the greatest downfalls in corporate American history.

Military advocates have long argued that the current military retirement system

needs no alteration. For service in the line of duty, it recognizes individuals who have given 20 or more years of honorable service and recognizes their personal sacrifice in holding up their end of their contract with the Federal Government. The current system is supported in strong conviction by retired and Active-duty Servicemembers alike. However, the financial numbers tell a different story and hint that the current model will be unsustainable in the future. Left untouched, it could endanger the military's ability to reward the performance of our future career force. The central question in the debate on military retirement is therefore how an individual who spends a career in a profession where the risk is the ultimate sacrifice should be compensated in retirement.

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U.S. Air Force (David H. Lipp)

had taken care of them in the greatest time of need.⁵

Periodic reassessments of the military retirement package have caused considerable tension. Since 1976, seven different panels have been charged with evaluating changes to the retirement system.⁶ The focus has always remained the same: how should Congress and the Services continue to offer a fair benefits package at a reasonable cost? This is the central problem in military retirement reform. The difficulty is not in acknowledging the value of Servicemember contributions, but in converting it to a valuation. Both Active-duty and retired military react emotionally to suggestions of changing the system, and the magnitude of the reaction has been significant enough to deter any significant reform. As a result, proposals in these commissions have never been wholly received and have resulted in small-scale changes only. The strong military sentiment suggests tremendous value in the object to those who serve, yet the relatively small compromises over the years have allowed financial expenditures to increase more rapidly. Pensions for over 2.2 million retired military personnel are a \$1.3 trillion liability (of which \$385 billion is funded) and are projected to grow to \$2.8 trillion by 2034.⁷ These are unsustainable costs even in the present time and remain projected to grow.

The Present

The criteria that collectively make up the military retirement system are based on a different time and place. Longevity, generational values, emphasis on work-life balance, and technology are all markedly different compared to societal attributes over a century ago. In 2011, life expectancy in the United States was 78 years, with millennium generational values centered on confidence, achievement, diversity, and competition.⁸ According to Thomas Friedman, this is a population that lives in the age of a flattening world where traditional structures are being transformed by globalization in ways that state-centric organizations are ill-equipped to deal with.⁹ This is the age of information and networking where greater control is placed in the hands of the individual. Military requirements are changing, too. The operational tempo is increasing, mission sets are diversifying, and recruiting remains keenly competitive. Coming out of multiple wars, America is also tending to have more

North Dakota National Guard adjutant general pins Meritorious Service Medal on Air Force chief master sergeant during retirement ceremony

It is legitimate for citizens to consider the value of military service as sacred. The value of military service itself and the contributions of members are priceless, but the question of retirement compensation is different. Any valuation must be based on criteria that must be reasonable in context. The current benefits offered in the U.S. military are based on historical assumptions of a century ago. Therefore, military retirement reform should not impact current retiree, Active, or Reserve personnel, but should be enacted for the future force. The preservation of benefits to recruit and retain the most qualified personnel and to incentivize honorable and dedicated service within the characteristics of the current generation should be implemented now. Both the Under Secretary of Defense for Personnel and Readiness and Assistant Secretary of Defense for Military Personnel Policy should consider alternatives to preserve retirement options for future career military members.

The Past

Military retirement holds a longstanding value for Servicemembers. Service in arms was a respected profession because of the extraordinary sacrifices of both warriors

and their families even before the Nation was founded. In 1636, the first law granting benefits was passed during the conflict between the Plymouth Pilgrims and Pequot Indians where “any man set forth as a soldier and returned maimed should be maintained by the colony for life.”² The system has evolved since then, but giving consideration to military retirees has remained. The current retirement plan took shape in the early 1900s, where after 20 years of honorable service a member was granted a percentage of basic pay, medical care, and indirect benefits such as commissary and exchange privileges for life.³ Lawmakers approved these benefits as a fair deal based on longevity, generational values, and fiscal approach. In 1910, life expectancy in the United States was 51 years, and significant events such as World War I, World War II, and the Great Depression shaped traditionalist values centered on discipline, conformity, and delaying rewards to oneself or one’s family.⁴ The focus was on service to country because the country had given so much to its citizens. When these values were translated into work requirements, it showed that dedication, diligent effort, and respect for authority were the driving factors in employment, especially in the government because citizens believed it

wounded warriors than ever.¹⁰ Many roles are fundamentally changing for both the officer and enlisted ranks, which will demand an even more highly competent force.

The financial environment is dramatically different. DOD is the focal point of the current budget reductions as wars conclude in Iraq and Afghanistan and looming foreign debts come due. Billions have already been slashed from budgets in recent years. With the failure of the Joint Select Committee on Deficit Reduction (the “Supercommittee”), an additional \$1.2 trillion in cuts will be spread among various government programs with Defense expected to assume \$600 billion of the total.¹¹ The size of the DOD budget should not be targeted simply for its size, but in this era it is important to realize greater efficiencies for the sake of future force planning.

What is valued in the current retirement model? It offers an exceptionally generous defined contribution benefit, medical care for members and their families, and exchange and commissary privileges for life. It is often not considered an incentive until a member passes 10 years of service due to its cliff vesting nature, but it is heavily prioritized afterward. Numerically, base pay is a significant financial incentive alone. For example, in 2012 an O5 retiring at 20 years of service can expect to earn \$3.028 million in retirement income over a 40-year timeframe.¹² An E7 would earn \$1.615 million over the same period. Retiring from the Service normally happens between 38 and 45 years of age, so by being relatively young with significant experience and proven discipline, many transition their talents to second careers.

The Future

With the sheer size of DOD cuts approaching nearly one *trillion* dollars, this financial reality is well beyond a cost-cutting exercise. This is a critical time for the military to restructure programs now instead of incurring a greater risk later through indiscriminate across-the-board cuts. This decade will be characterized by a shift from effectiveness to efficiency. Resources will be adjusted to fit the needs of future contingencies. Personnel policies should not be excluded from consideration. Policy is not etched in stone and remains flexible if stakeholders are. Although fiscal arguments have been rebuffed for decades, military retirement is not a sacred cow, and it must

be flexible in order to preserve a benefit for future generations. Recognizing a Marine’s sacrifices is not the issue. The issue, rather, is to what end.

If DOD considers people to be its critical strength in executing the defense of the Nation, it needs to remake a retirement policy to conform to 21st-century realities. Retirement reform should be evaluated on five criteria: retirement eligibility, the direct benefit, type of contribution benefit plan, indirect benefits, and vesting. Table 1 outlines a proposed alternative based on these measures.

The proposed alternative is meant not only to preserve the value of a military retirement but also to promote performance and active ownership of retirement savings. It is based on two central tenets: earn your keep and pay yourself first. The current generation has demonstrated incredible skill in accessing and applying information but seems to lack the discipline to plan for the long term. This core incentive capitalizes on the high degree of individuality but stems the “earn to spend” mentality by regularly contributing to future savings.

Recognizing a graying workforce that will work longer, retirement eligibility should be a factor of age and years of service. The “Rule of 80” (see table 2) has been used by various groups such as local governments, Federal judges, and school districts. By making the sum of age and service equal 80, it is possible to maintain an Active-duty force predominantly between the ages of 18 and 60. With the physical nature of military work, a greater majority will likely continue to enter at younger ages, but this system would allow multiple on- and off-ramps and keep personnel in service until their late 40s to early 50s on average. The current retirement system does not facilitate force management or encourage longer careers, a key opportunity since the retirement age usually allows personnel to move on to second careers.¹³ This alternative would retain more senior personnel who provide critical leadership, corporate knowledge, and mentorship to younger generations, a key factor bridging the gap.

The direct benefit should be a base salary that recognizes a combination of two

Table 1. Current and Proposed Retirement

Attribute	Current	Proposed alternative
Eligibility	20 years	Age + Years of service (YOS) = 80
Direct benefit	<ul style="list-style-type: none"> ■ Incentivized by YOS ■ Percentage of base pay 	<ul style="list-style-type: none"> ■ Incentivized by performance ■ Minimum pension (lesser percentage of base pay) + performance base (competency weighted by individual personnel tempo)
Contribution benefit plan	<ul style="list-style-type: none"> ■ Noncontributory ■ Government managed 	<ul style="list-style-type: none"> ■ Contributory ■ Privately managed ■ Mandatory ■ Government matching (above minimum contribution levels) ■ Transferrable
Indirect benefits	<ul style="list-style-type: none"> ■ Medical (100%) ■ Exchange ■ Commissary 	<ul style="list-style-type: none"> ■ Medical (to be determined) ■ Exchange ■ Commissary
Vesting	20 years	10 years

Table 2. Retirement Eligibility Under the “Rule of 80”

Starting age	Years of service	Retirement age
18	31	49
20	30	50
25	27.5	52.5
30	25	55
35	22.5	57.5
40	20	60

factors: years of service and type of duty. By creating a formula for retirement compensation that factors job field (signified by, for example, Navy enlisted classification or military occupational specialty) and weights it by risk incurred (measured by individual personnel tempo or time spent deployed), the retirement system could recognize a more realistic measure of hardship. This model reflects performance in duties assigned as a measure of the risk they assume, including how often they are subject to those conditions. For example, this framework would recognize that a Navy special operator (SEAL) performs markedly different tasks than a yeoman (administrative assistant). Multiple variables could actually be considered in this equation, too. Competency-based knowledge and job risk are just two factors.

A mandatory contribution benefit plan would complement the direct benefit and reward Servicemembers for saving. The government of Chile, for instance, instituted a mandatory, privately managed defined contribution plan of this type. Instead of having a government-run social security system (which went bankrupt in Chile during the 1980s), everyone earning a paycheck contributes a mandatory 10 percent that is bankrolled into a privately managed account that remains under the control of the citizen.¹⁴ It is termed an enhanced defined contribution because of a discretionary government match on contributions above the minimum level. Interestingly, some have questioned why that matching has not incentivized more citizens to save since most do not contribute above the minimum.¹⁵ However, the pension returns speak for themselves. The privately managed fund has posted gains of 10.3 percent on average since 1981 as citizens maintain control over their asset allocations.¹⁶ In the U.S. case, government match-

ing should be effected in a similar manner to promote the sound, long-term financial habits of Servicemembers. Matching should be allowed at any pay grade. For example, using Chile’s 10 percent as a base, a one-for-one match up to 6 percent would allow a Soldier to save up to 22 percent of a base pay for the price of 16 percent. Given the quality of entitlements to today’s Servicemember, it is feasible for them to save in this fashion.

Healthcare benefits are extremely important to the quality of life for military beneficiaries and have a profound impact on a Service’s ability to recruit and retain quality personnel. However, medical benefits should be reserved for a separate discussion. This is a complex issue and there is significant uncertainty on how to best assign the cost of care. Providing affordable and accessible care for uniformed members and retirees who have served is a national tradition

chooses to separate before being retirement eligible. Currently, only 17 percent of total military personnel perform 20 years and therefore qualify for vesting, allowing a select few who complete service to benefit.¹⁷ The “all or nothing” system results in a mix of personnel who are dedicated performers or are waiting out their time. Reducing the time required to gain a transferrable benefit acknowledges Sailors’ contributions and gives them the flexibility to pursue another career path, providing a force that is committed to the military profession.

Finally, the payout date should remain unchanged from the date of retirement. If we assumed the majority of retirements would be occurring between 49 and 53 years of age, payouts would last 25 to 30 years on average, thereby reducing the current obligation, which pays for 40 years of retirement. This would effectively reduce retirement incomes by 25 to 38 percent. Immediate payout is deserved and recognizes the unique value in military service and sacrifice.

Conclusion

There is no comparative retirement compensation system in the private sector that can match the military’s benefit. In this time of change, it is crucial to preserve an honorable recognition of service but within fair economic reason. In our present time, the current system is unfair, unaffordable, and inflexible.¹⁸ This issue is not about emotion, defending a longstanding benefit,

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and responsibility, but just as in the civilian sector, costs are out of control. Health care unaffordability in the status quo must lead to numerous alternatives that will be discussed further. Care for military personnel and retirees needs to remain mandatory, but the level of care and expenditures needs continued debate.

Flexibility can be built into the retirement system by reducing the vesting period. It is unrealistic to wait 20 years to receive any benefit. If vesting is offered after a 10-year initial term, an Airman will have fulfilled a military obligation. The individual is incentivized to remain within the force but will have a transferrable benefit if he or she

or dishonoring a group of well-qualified individuals. It is an issue of financial responsibility and planning to effectively recruit, retain, and offer a retirement benefit to a future career soldier.

There are numerous proposals currently available on how to accomplish military retirement reform, but few focus on generational values and demographic information. Revising a program based on characteristics from the current population (not from the 1900s) can be accomplished while preserving the benefit of honest and faithful service. In other words, this should not be an exercise in older policymakers telling younger Servicemembers what they

want or what they are entitled to. Neither knows what the other wants, but collectively it is critical for both to have the dialogue to discern those items of value. Findings from other reports have confirmed that there are opportunities to make retirement compensation more efficient at delivering value to the Servicemembers. Reform needs to be accomplished within the resource constraints in existence today.

Additionally, it is best if proposed recommendations come from the military itself. Although current Servicemembers and retirees would not be subject to a new system, a military-originated solution shows that the current generation is taking careful consideration of the next with a new policy that assumes ownership of the issue, which has become a top concern of military members since discussion of reform intensified in 2011. The Secretary of Defense has stated that this issue is not off the table and that it must be considered for modification.¹⁹ The Services would be wise to understand their respective populations (especially junior officer and enlisted personnel) to create their own solutions for the future career force. These could be collectively debated at the level of the Joint Chiefs of Staff with final recommendations altered only in size (not scope). There is little likelihood that a solution will be wholly adopted by an outside group and even less chance of it happening during an election year.

If DOD does not reform military retirement now, the alternative case is precisely what GM experienced. The rigidity of management, rejection of change, and failure to adhere to financial indicators over many years placed GM in a position that was unsustainable and affected current employees and retirees alike. Management failed to understand not only the company's situation, but also how their decisions would have ripple effects for years to come. Righting the ship (especially one as large as GM) was not a simple task, but it had to start somewhere. By restructuring the organization, obtaining government assistance, focusing on a central vision, and openly communicating with company employees, new leadership was able to create more sustainable practices. This alternative system provides one way to correct the course for the military retirement issue, combining a government benefit with an individual retirement plan that involves members playing an active role in managing

their nest eggs. This preserves the value of military retirement but adjusts the benefits package in line with the current generation and plans for the warriors of our future force.

JFQ

NOTES

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⁷ Department of Defense Office of the Actuary, *Valuation of the Military Retirement*, September 30, 2007, available at <<http://actuary.defense.gov/Portals/15/Documents/valbook2007.pdf>>; Defense Business Board, slide 9.

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¹⁶ Piñera.

¹⁷ Defense Business Board, slide 8.

¹⁸ *Ibid.*, slide 15.

¹⁹ Josh Fishel and Jim Crogan, "Panetta: 'You Have to Consider' Military Retirement Reform," *Foxnews.com*, August 16, 2011, available at <www.foxnews.com/politics/2011/08/16/panetta-have-to-consider-military-retirement-reform/>.